

SIDLEY & AUSTIN
A PARTNERSHIP INCLUDING PROFESSIONAL CORPORATIONS

CHICAGO
DALLAS
LOS ANGELES
NEW YORK

1722 EYE STREET, N.W.
WASHINGTON, D.C. 20006
TELEPHONE 202 736 8000
FACSIMILE 202 736 8711

HONG KONG
LONDON
SHANGHAI
SINGAPORE
TOKYO

FOUNDED 1866

WRITER'S DIRECT NUMBER
(202) 736-8132

March 22, 2000

RECEIVED
MAR 22 2000
FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY
WRITER'S E-MAIL ADDRESS
pkeisler@sidley.com

ORIGINAL

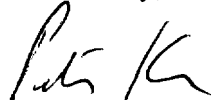
Magalie Roman Salas
Secretary
Federal Communications Commission
The Portals
445 12th Street, S.W.
Washington, D.C. 20554

Re: *GTE Corp. and Bell Atlantic Corp., CC Docket No. 98-184*

Dear Ms. Salas:

Attached is a letter from me and a Declaration by Professor John C. Coffee concerning Bell Atlantic and GTE's proposal regarding GTE's InterLATA operations. Please place the attached letter and Declaration in the public record for the above-referenced proceeding.

Yours truly,


Peter D. Keisler

cc: Dorothy Attwood
Rebecca Benyon
Michelle Carey
Kyle Dixon
Jordan Goldstein
Johanna Mikes
Paula Silberthau
Lawrence Strickling
Sarah Whitesell
Christopher Wright

No. of Copies rec'd
List ARCADE

012

SIDLEY & AUSTIN

A PARTNERSHIP INCLUDING PROFESSIONAL CORPORATIONS

CHICAGO
DALLAS
LOS ANGELES
NEW YORK

1722 EYE STREET, N.W.
WASHINGTON, D.C. 20006
TELEPHONE 202 736 8000
FACSIMILE 202 736 8711

HONG KONG
LONDON
SHANGHAI
SINGAPORE
TOKYO

FOUNDED 1866

WRITER'S DIRECT NUMBER
(202) 736-8132

WRITER'S E-MAIL ADDRESS
pkeisler@sidley.com

March 22, 2000

Magalie Roman Salas
Secretary
Federal Communications Commission
The Portals
445 12th Street, S.W.
Washington, D.C. 20554

Re: *GTE Corp. and Bell Atlantic Corp., CC Docket No. 98-184*

Dear Ms. Salas:

On behalf of AT&T Corp. ("AT&T"), this *ex parte* letter responds to the most recent filing made by Bell Atlantic Corp. and GTE Corp. (collectively "Applicants") on their proposal regarding GTE's interLATA assets.¹

The economic reality of Applicants' proposal is now undisputed. Applicants have admitted that the market would value the Class A DataCo shares sold to the public at 20 percent of the total value of DataCo, and the Class B shares owned by the merged entity at 80 percent of DataCo. Response at 8; *Ex Parte* Letter from Patricia Koch to Magalie Salas, Att. 2 (Dec. 24, 1999). In other words, the value of Bell Atlantic's Class B shares reflect the fact that their holder is entitled to 80 percent of the earnings of DataCo. In light of this reality, Applicants have

¹ Reply of Bell Atlantic and GTE to AT&T's March 10 *Ex Parte*: The DataCo Proposal is Fully Consistent with the Communications Act and Furthers the Purposes of Section 271 (March 14, 2000) ("BA-GTE *Ex Parte*"); Supplemental Declaration of Professor Ronald Gilson (March 14, 2000) ("Gilson Supp. Dec."). See also Response of Bell Atlantic and GTE in Support of Proposal to Transfer GTE Internetworking to a Separate Corporation Owned and Controlled by Public Shareholders (Feb. 22, 2000) ("Response"); Declaration of Ronald Gilson (Feb. 22, 2000) ("First Gilson Dec."); Supplemental Filing of Bell Atlantic and GTE (Jan. 27, 2000) ("Supp. Filing").

informed the investment community that they will recognize 80 percent of the income from DataCo as a separate line item on their income statement. G. Woodlief, Prudential Securities Analyst Report (Feb. 3, 2000) (attached hereto at Tab A).

That is why Applicants must argue so strenuously that the Commission may artificially treat the Class B shares Bell Atlantic would receive as being composed of two separate instruments – “pure” common voting stock and an “option” – and that the existence of the “option” is not relevant to whether Bell Atlantic would “own” or “control” DataCo within the meaning of Section 3(1) of the Communications Act (“the Act”), 47 U.S.C. § 153(1). But Applicants’ most recent submission abandons the analysis on which they previously relied to support that unnatural conclusion. In their prior filings, Applicants recognized that “ownership” and “control” were distinct inquiries under Section 3(1) of the Act;² that the test for “ownership” was whether they would have an “equity interest (or its equivalent)” in DataCo of greater than 10 percent;³ and that this “equity interest” could include a variety of non-voting instruments (such as, for example, non-voting stock and some forms of debt).⁴ They claimed, however, that the law establishes a “sharp boundary between an option and an equity security,” and that what they refer to as their “option” did not “count” as an “equity security.” See Gilson Dec. ¶ 17. In support of these claims, Applicants submitted the Declaration of Professor Ronald Gilson, who relied upon Rule 144 promulgated by the Securities and Exchange Commission (“SEC”) pursuant to the Securities Act of 1933 (and whose analysis included no other citations of authority). See *id.*

AT&T subsequently demonstrated that the securities laws establish the opposite of what Applicants contended.⁵ The BA-GTE *Ex Parte* thus reverses course. Remarkably, it chides AT&T for citing the securities laws, which are now said to be “irrelevant to the issue of equity ownership and control” presented here. See BA-GTE *Ex Parte* at 1. It also attaches a new Supplemental Declaration in which the same Professor Gilson opines about the purposes of Section 271 of the Communications Act instead. Applicants’ new central argument is that, at least under the Communications Act, the “ownership” inquiry is itself simply another inquiry into “control,” such that in the absence of “control,” there can be no “ownership.” See BA-GTE *Ex Parte* at 2 (for “a BOC to circumvent the limitation of section 271 through another company – *i.e.*, an ‘affiliate’ under section 3(1) – the BOC must have the ability to control it”) (citing Gilson Supp. Dec. ¶ 24). Applicants defend this countertextual conclusion as consistent with the “purposes” of Section 271, which, Applicants contend, are limited to concerns about control and do not separately bar a BOC from “earning significant returns” from “long distance companies.” See *id.* at 6. Applicants then contend that the Commission can, and should, interpret Section 3(1)

² See Supp. Filing at 34-49.

³ See *id.* at 34.

⁴ See *id.* at 35 n.21; Response at 5.

⁵ See *Ex Parte* Letter from Peter D. Keisler to Magalie Roman Salas (March 10, 2000) (“AT&T *Ex Parte*”); Declaration of Professor John C. Coffee, Jr. (“Coffee Dec.”)

in the Act's "Definitions" section consistent with these claimed limits on Section 271's purposes. *Id.*

Applicants' new position is as untenable as their previous one. Indeed, it is wrong on every level, both substantive and methodological. As to substance, the plain terms of Section 3(1), which define an affiliate as a firm that "is owned *or* controlled" by another firm, establish that "ownership" is not redundant of "control." That is because, as the statutory language makes clear, Congress was properly concerned with both. Even in the absence of control, the economic benefits of having an ownership interest in a long-distance business would alter a BOC's incentives in precisely the way Section 271 seeks to prevent – by increasing its incentives to discriminate in favor of that business and by decreasing its incentives to open its local markets to competition. Indeed, under Applicants' view, even a purely "passive" 100 percent equity interest (*i.e.*, complete economic ownership without voting rights) would be permissible. But Congress in Section 3(1) provided otherwise – and foreclosed Applicants' cramped view of its purposes.

Even more fundamentally, Applicants have not only given the wrong answer, they have posed the wrong question. The terms at issue here are located not in Section 271, but in Section 3 – the Definitions section of the Act – and apply simultaneously to a dozen or more separate provisions of the Act. While some Sections of the Act – such as Sections 273 and 274 – contain within them definitions of "affiliate" that are specific to those sections, *see, e.g.*, 47 U.S.C. §§ 273(d)(8)(A), 274(i)(1), that is not the case with respect to Section 271. And because Section 3(1) must be uniformly applied throughout the Act, Applicants' discussion of the purposes of Section 271 would be irrelevant to the terms "own," "control," and "equity" in Section 3(1) even if that discussion accurately characterized those purposes (as it does not). The statutory terms in Section 3(1) must be construed and applied according to their accepted meaning in the law, not according to a corporate finance law professor's (mistaken) claims regarding the purposes of merely one of the numerous sections of the Act in which the defined term appears.

And the meaning of those terms is clear over a wide range of legal contexts. For example, as noted above, Applicants no longer deny that the securities laws define convertible instruments and options as "equity securities." They now claim instead that those laws are irrelevant to this proceeding because the securities laws, they say, embody different purposes that are separate from the issues of ownership and control that are implicated by their interLATA proposal. That is wrong, as is explained in the attached Supplemental Declaration of Professor John C. Coffee, Jr., the Adolph A. Berle Professor of Law at Columbia Law School. Indeed, the securities laws are directly relevant to the purposes of Section 271 even under Applicants' crabbed view of those purposes, because the securities laws are directly concerned with how and whether holders of "equity securities" can use those securities to "control" corporations.

In contrast to their about-face on the securities laws, Applicants continue to maintain that the Commission rules adopted in the *Cable Attribution Order*⁶ and the *Broadcast Attribution*

⁶ Report and Order, *Implementation of 1992 Cable Act*, CS Docket No. 98-82 (Oct. 20, 1999).

*Order*⁷ exclude convertible securities from consideration as attributable interests under the “equity plus debt” rule. But that is false, and the language of the cited orders does not leave room for reasonable debate. As AT&T has previously shown, the *Cable Attribution Order* explicitly addressed this precise issue in footnote 329, and its holding is unambiguous: convertible securities are attributable where (as here) they exceed 33 percent of the value of corporation.⁸ With respect to the *Broadcast Attribution Order*, AT&T previously demonstrated that the quotations from that Order on which Applicants previously relied describe prior rules that were *replaced* by the new 33 percent rule.⁹ In their recent *ex parte*, Applicants simply rely on the outdated and superseded rules once again. See BA-GTE *Ex Parte* at 12.

Furthermore, like the securities laws, those rules would be pertinent even if Applicants were correct that the sole focus of Section 3(1) were control and not ownership, for the attribution rules are designed to determine, among other things, the extent of control among entities subject to regulatory requirements. And that further confirms yet another reason why Applicants’ effort to conflate ownership and control is a non-starter: even if the sole test under Section 3(1) were one of control, that is not a test Applicants could pass. Under Applicants’ proposal: (1) existing GTE and Bell Atlantic executives would simply be moved laterally to DataCo; (2) each would know that he or she is certain to return to the merged entity once the conversion right is exercised, and that his or her professional career depends on satisfying the superiors at GTE and Bell Atlantic; (3) GTE and Bell Atlantic would select each member of DataCo’s initial Board of Directors; (4) no other shareholder would be permitted to vote more stock than GTE and Bell Atlantic; (4) GTE and Bell Atlantic would be able to veto any major corporate decision by DataCo pursuant to the “Investor Safeguards”; and (5) DataCo would be dependent on GTE and Bell Atlantic for network capacity management, research and development (“R&D”), and the numerous other critical matters that would be the subject of the “commercially reasonable” contracts between these entities. There is no question but that these rights would give the merged entity control of DataCo in every sense. Indeed, these rights are so redundant of one another – they reflect several different ways of retaining control, most of which would be entirely sufficient for that purpose standing alone – that Applicants must have included them simply so that they would have some things to “deal away” in negotiations with the Commission without losing the element of control that is the central organizing principle of their proposal.

⁷ Report and Order, *Review of the Commission’s Regulations Governing Attribution of Broadcast and Cable/MDS Interests*, 14 FCC Rcd. 12559 (1999).

⁸ See Opposition of AT&T Corp. to Applicants’ Proposal Regarding GTE’s InterLATA Operations, at 13-14 (Feb. 15, 2000) (“AT&T Opp.”); AT&T *Ex Parte* at 7-8 & n.6.

⁹ See AT&T Opp. at 15.

Finally, these points are vividly confirmed by the Commission's recent *Qwest-US WEST Merger Order*.¹⁰ In the Qwest-US WEST merger proceeding, it was undisputed that Section 271(a) prohibited US WEST from acquiring or operating Qwest's interLATA facilities in US WEST's 14 state regions. Accordingly, in order to bring their merger into compliance with Section 271(a), Qwest and US WEST proposed to "identify all in-region customers that utilize interLATA services and transfer all such customers to an unaffiliated third party buyer before the merger closes." *Qwest-US WEST Merger Order* ¶ 14. Qwest and US WEST further recognized that "in order [for this plan] to fully comply with section 271, the buyer must be independent of Qwest, and that the divestiture of customers must be *final* and *irrevocable* – i.e., *Qwest will have no preferential right to reacquire the customers it divests.*" *Id.* (emphasis added).

However, McLeod submitted evidence suggesting that the planned divestiture might be a sham. Rather than transfer the customers to an independent third-party, McLeod claimed that Qwest instead planned to "sell the divestiture assets to a 'friend'" and "park the assets for later reacquisition." *Id.* ¶ 21. Qwest vigorously denied these charges, asserting that it intended to "make divestiture final and irrevocable." *Id.* While the Commission credited Qwest's representations, it nonetheless required Qwest and US WEST to provide a detailed report so that it could ensure that the divestiture complied with Section 271. *Id.* ¶¶ 23-25.

Here, Applicants go well beyond the allegation that they have secured a friendly buyer from whom they would enjoy merely a "preferential right" to reacquire "divested" interLATA assets. Rather, as Applicants concede, they would have an *absolute legal* right to "reacquire" GTE's interLATA assets with no additional expenditure upon receiving Section 271 relief. Supp. Filing at 30-31. Indeed, Applicants have justified the various restrictions that they would place on the operations of DataCo – the company that would be given GTE's interLATA facilities – as necessary to assure that Bell Atlantic "will get the business it agreed to purchase." Gilson Dec. ¶ 25.

In the remainder of this letter, and in the attached Supplemental Declaration of Professor Coffee, we develop these points in further detail.

Ownership

We respond in this section to the arguments made in the BA-GTE *Ex Parte* on ownership. First, we show that Professor Gilson is wrong in suggesting that the purposes of Section 271 are served by prohibiting only situations in which the BOC controls a long-distance company and in claiming that Section 271 is not, by contrast, concerned about ownership of a long-distance company in the absence of control. Second, we show that the purposes of Section 271 are in any

¹⁰ Memorandum Op. and Order, *Qwest Communications Int'l, Inc. and US WEST, Inc., Applications for Transfer of Control of Domestic and International Sections 214 and 310 Authorizations and Application to Transfer Control of a Submarine Cable Landing License*, CC Docket No. 99-272 (March 10, 2000).

event irrelevant to construing the terms “own,” “control,” and “equity” in Section 3(1) of the Act, which applies to numerous provisions other than Section 271 and which must be given a uniform construction pursuant to the settled meaning of those terms. And third, fourth, and fifth, we show that the securities laws, Commission precedent, and the MFJ all reject Applicants’ claims that convertible interests like theirs can or should be ignored for purposes of determining “ownership.”

1. *Applicants’ New Claim That Section 271 Is Concerned Solely With Control And Not Ownership.* Applicants now advance an argument under which the Commission would not need to concern itself with the plain language of Section 3(1), the Commission’s interpretation of analogous provisions of the Communications Act, or the federal securities laws they previously miscited that define and apply concepts of “equity” and “control.” BA-GTE *Ex Parte* at 1-4. They argue instead the Commission should adopt a unique construction of Section 3(1) based on what they claim to be the sole purpose of Section 271. *Id.* According to Applicants, “ownership” interests which would give them “mere” economic benefits from an entity providing interLATA services are irrelevant to Section 3(1), and the Act is indifferent to whether a BOC is “earning significant returns” from “long distance companies.” Rather, “Section 271 and the Act’s definition of affiliate are . . . ultimately concerned with the . . . capacity of a party to *control*, through ownership of an equity interest,” and do not prohibit ownership interests in the absence of control. *Id.* at 1, 6; *see also id.* at 3, 4.

Applicants do not cite any basis for this construction in the text or legislative history of Section 3(1). Instead, they cite their corporate finance authority, Professor Gilson, on the purposes of Sections 3(1) and 271. According to Professor Gilson, “Section 271 is not concerned with a Bell operating company’s passive investment . . . because such investments do not provide a means for a Bell operating company to achieve the benefits of in-region bundling of services without FCC approval; *i.e.*, without opening its local markets to competition.” Gilson Supp. Dec. ¶ 25. Based on this view, Professor Gilson opines that “Section 271 and Section 3(1) are not directed at *value* equivalence, but *control* equivalence – the capacity to exert influence over the activity that required FCC approval as would an equity interest.” *Id.* ¶ 26. Therefore, according to Professor Gilson, to be relevant to the “purposes of the Communications Act,” an equity security must have voting rights. *Id.* ¶ 10 & n.5; *see also id.* ¶¶ 5-6, 10-11, 24-26.

As with his first Declaration, Professor Gilson cites virtually no authority for his claims (only the *Qwest-Ameritech Order*,¹¹ which, as explained below, he misunderstands). And as with his first Declaration, the pertinent authorities reject his claims.

The foremost authority is the text of Section 3(1). Section 3(1) (in conjunction with Section 271(a)) prohibits a BOC from “own[ing] *or* control[ing]” an entity providing interLATA services. 47 U.S.C. § 153(1) (emphasis added). The prohibition is framed in the disjunctive. Under Applicants’ reading of the statute, however, the term “owned” would be superfluous because ownership interests would be relevant only when they also convey “control.”

¹¹ *AT&T Corp. v. Ameritech Corp.*, 13 FCC Rcd. 21438 (1998).

Applicants cannot escape this plain language by saying that the provision of Section 3(1) that limits ownership to less than a 10 percent equity interest is merely “an attribution rule – a presumption that ownership in excess of 10% grants control.” BA-GTE *Ex Parte* at 5. By defining the term “own” to mean “an equity interest (or its equivalent) of more than 10 percent,” Congress was not creating a “presumption” that a 10 percent equity interest was ownership, but conclusively establishing that this level created ownership. If Congress had wanted to adopt Applicants’ view, it would simply have eliminated the terms “owned” and “own” in the statute and instead defined the term “control” to include “an equity interest (or its equivalent) of more than 10 percent.” Indeed, the only way in which the term “own” could have any independent meaning under Applicants’ view is if the 10 percent equity cap Congress established was irrationally broad and swept in ownership interests that gave no control – which would contradict Applicants’ claims regarding the statutory purpose.

Likewise fatal to Applicants’ argument is that Congress defined ownership in terms of both “equity” and its “equivalent.” Applicants do not deny that the ordinary understanding, and the understanding for purposes of the federal securities laws, is that two things are “equivalent” if they are “equal in value.” Coffee Dec. ¶ 20. Instead, they argue that the Commission should ignore the well-established meaning of equivalence in order to further the “purposes” of Section 271, which, as noted, they say is only concerned with voting equity interests that can give control. BA-GTE *Ex Parte* at 5-6; Gilson Supp. Dec. ¶ 26.

But it is nonsense to suggest that the Commission can determine Congress’ purpose independently – and in contradiction – of the words it used in the statute. As the Supreme Court has explained, “vague notions of a statute’s ‘basic purpose’ are . . . inadequate to overcome the words of its text regarding the specific issue under consideration.” *Mertens v. Hewitt Associates*, 508 U.S. 248, 261 (1993) (citing *Pension Benefit Guaranty Corporation v. LTV Corp.*, 496 U.S. 633, 646-647 (1990)). “This is especially true” when dealing, as here, with an “enormously complex and detailed statute that resolved innumerable disputes between powerful competing interests . . .” *Mertens*, 508 U.S. at 261 (citing *Pilot Life Ins. Co. v. Dedeaux*, 481 U.S. 41, 54-56 (1987)). In that regard, even where there is tension between competing goals, courts will reject any “attempt to adjust the balance between those competing goals that the text adopted by Congress has struck.” *Mertens*, 508 U.S. at 263.

Indeed, that Applicants’ argument has no basis in the text of Section 3(1) is made plain by their prior filings in which both they and Professor Gilson repeatedly recognized that “passive” equity interests without any voting interests are the “equivalent” of equity. For example, in their Supplemental Filing, Applicants stated:

The parenthetical phrase “(or the equivalent thereof)” in section 3(1) is reasonably read to encompass ownership interests that may not carry the voting rights or usual form of common stock but that still carry the traditional rights of equity ownership, including, most importantly, the right to receive a current share of the profit. Such interest may include partnership shares or instruments nominally characterized as debt, such as promissory notes

Supp. Filing at 35 n.21. Likewise, Professor Gilson opined in his initial declaration that:

The phrase ‘equity (or equivalent thereof)’ . . . *must be read* to capture interests that may not be styled as common stock or that may lack voting rights For example, in appropriate circumstances, debt interests that confer the right to participate in earnings rather than receive simple interest, and nonvoting preferred stock that also participates in earnings as well as receiving a fixed dividend, may serve as equity equivalents.

Gilson Dec. ¶ 18 (emphasis added). In short, having conceded that Section 3(1) “must be read” to include such passive investments as preferred stock or even certain debt instruments, there is no room for Applicants to argue that the only relevant “equity” for purposes of Section 3(1) is equity that gives the power to control through voting rights.

Applicants’ argument is also refuted by the only authority they cite – the *Qwest-Ameritech Order*. Applicants claim that this Order established that Section 271 is not violated unless the BOC is engaged in the “active participation in the provision of long distance services,” and that merely earning returns from the provision of such services is unobjectionable. See BA-GTE *Ex Parte* at 3. Professor Gilson likewise claims that *Qwest-Ameritech Order* established a “link between Section 271 and service bundling,” and notes that no such “service bundling” is at issue here. But there was no suggestion by any party in that proceeding that Ameritech or U S WEST had acquired any “ownership interest” in Qwest; the only claim was that these BOCs were illicitly participating in the long-distance business *through improper service bundling*. So of course the Commission identified that aspect of that particular arrangement as the unlawful conduct at issue in that case. The Commission did not remotely suggest – as Applicants’ argument claims – that the *only* way a BOC could violate Section 271 was by entering into such “service bundling” arrangements.

To the contrary, even in that limited context, the Commission made plain that Section 271(a) is implicated even where a BOC has a “mere” economic interest in a interLATA carrier, regardless of its ability to “control” that carrier. Thus, in the *Qwest-Ameritech Order* the Commission determined that a BOC’s incentive to comply with Section 271(a) will depend critically on whether it is able to “obtain[] material benefits” from the provisioning of interLATA services. *Qwest-Ameritech Order* ¶ 37. And in that case, one of the “material financial benefits” the BOCs obtained were proceeds directly tied to the sale of Qwest long distance services. *Id.* ¶ 43. Here, Bell Atlantic would capture 80 percent of the earnings that DataCo would derive from providing interLATA services.¹² Indeed, if Bell Atlantic did not foresee the ability to earn sizeable profits from acquiring GTE’s data businesses, it would divest those assets just as it was willing to do with GTE’s less remunerative long distance voice business.¹³

¹² This would be a tidy sum. GTE’s data business currently generates nearly \$800 million a year. http://www.bbn.com/announcements/news/press_release_19991213-01.xml; GTE 1998 Annual Report at 13.

¹³ The arbitrary nature of Applicants statutory construction is also highlighted by the fact that in the *Qwest-Ameritech Order* the Commission was construing the term “provide” in Section 271(a).

(continued . . .)

As the text of the Act and the *Qwest-Ameritech Order* thus confirm, Congress was properly concerned with ownership as well as with control. A BOC that is “earning substantial returns” from a “long distance compan[y]” will have its incentives altered in precisely the ways Section 271 seeks to prevent: it will have enhanced incentives to discriminate in favor of that company and thereby increase its returns,¹⁴ and diminished incentives to open its local markets so as to obtain such returns.¹⁵

Applicants nonetheless claim that “mere” economic ownership of DataCo cannot be important in this context because GTE could simply sell its data business prior to the merger and Bell Atlantic would lawfully be entitled to those proceeds when it merged with GTE. BA-GTE *Ex Parte* at 3, 8. But the difference between Bell Atlantic having an ownership interest in a long-distance carrier (which it does under Applicants’ proposal) and having money but no such interest (which it would if GTE sold its data business first) is fundamental. As soon as Bell Atlantic acquires a significant economic stake in the success of DataCo, it immediately has the incentive to act so as to enhance DataCo’s value. By contrast, if DataCo were truly spun off prior to the merger, Bell Atlantic would have a pot of money to play with – and could invest it in any way permitted by the Communications Act – but would have no incentive to discriminate in favor of DataCo.¹⁶

Applicants’ related claim – that allowing them to consummate their merger without fully divesting GTE’s data business would advance the purposes of Section 271 by giving them “more” incentive speedily to open their markets to competition, BA-GTE *Ex Parte* at 2 – stands that

(... continued)

Thus, Applicants’ position is that the term “owned” in Section 3(1) should not be construed based on its statutory definition – “equity interest (or the equivalent thereof)” – but instead should be deemed synonymous with “provide” in Section 271(a).

¹⁴ *Accord Tel-Optik Case* at 7 (holding conditional interests gives BOCs an “obvious economic incentive” to discriminate).

¹⁵ See *SBC Communications, Inc. v. FCC*, 154 F.3d 226, 243 (5th Cir. 1998); Evaluation of United States Department of Justice, *Application of SBC Communications Inc. Pursuant to Section 271 of the Telecommunications Act of 1996 to Provide In-Region, InterLATA Services in the State of Oklahoma*, CC Docket 97-121, at 6 (May 16, 1997).

¹⁶ Similarly, Applicants note they can invest the amount of money they would earn from selling DataCo in numerous companies (so long as they stay below the 10 percent equity cap) and that such investments in total are equivalent to Bell Atlantic having full economic ownership in DataCo. See BA-GTE *Ex Parte* at 3, 8. But Applicants are now simply arguing with Congress. Congress recognized that economic ownership of interLATA carriers would give BOCs the incentive to discriminate, but determined that for investments below 10 percent those incentives were acceptably small. It quite reasonably made a different determination for the situation in which the investment in any one company exceeds 10 percent.

provision on its head. The greatest such incentive will be created by enforcing the Act according to its terms so that Bell Atlantic must open its markets before it can acquire any significant ownership interest in a long-distance carrier. Diluting that requirement by permitting Bell Atlantic to obtain such an interest prior to Section 271 approval diminishes that incentive. After all, even under Applicants' logic, if they only had four years to obtain the necessary Section 271 authorizations and convert their Class B shares, that would, by definition, give them more incentive quickly to comply with the market-opening provisions of the Act than under their current proposal (which gives them five years). And if they had only three years, that would give them more incentive than four years. Moving down to two years and then one year would increase those incentives further. And moving from one year to none would give them maximum incentive to open their markets quickly. But that last option would simply restore the incentive scheme to the one that exists today under the Act, and the one that would be accomplished by denying Applicants' claims.

By contrast, Applicants' proposal moves Bell Atlantic's incentives in the direction of holding off opening its market for five years, because it can obtain at least some of the economic advantages of being in the interLATA market without opening its local markets to competition. Any appreciation in the value of DataCo during the 5-year period would flow to Bell Atlantic when Bell Atlantic converts or sells its Class B shares. And those benefits are substantial: as noted, GTE's data business earns nearly a billion dollars in revenues a year today, and long distance traffic is increasingly moving in the direction of "data" instead of voice.

Finally and in all events, Applicants' arguments are irrelevant because they seek to justify a transaction that does not exist. Even if Section 3(1) was only concerned about equity that gave the holder a voice in management, there can be no dispute that the Class B shares would give Bell Atlantic such a voice. See *AT&T Ex Parte* at 3; Coffee Dec. ¶¶ 24-26. Applicants' Class B shares are a *single* equity instrument possessing all three of Applicants' claimed "indicia" of equity – voting rights, liquidation rights and earnings rights. Applicants response – that "these rights will only attach to BA/GTE's 10% equity interest; they do not attach to the passive option portion of its interest" – is mere *ipsi dixit*. As Professor Coffee demonstrated, Bell Atlantic cannot be said to hold an "option" in any meaningful sense but rather has the "right to convert \$1 to \$8 for five years." Coffee Dec. ¶ 19.¹⁷

And even accepting Applicants' "thought experiment" in which a single instrument is treated as if it were two separate instruments, Applicants have no response at all to Professor Coffee's analysis that shows that even if Bell Atlantic only held an option without any common

¹⁷ One reason Applicants have not proposed creating two separate instruments may be that, as one of the cases Applicants cited states, "pure" options can be thought of as "a continuing offer to sell." *Ball v. Overton Square, Inc.*, 731 S.W.2d 536 (Tenn. Ct. App. 1987). Thus, to form a valid contract, exercise of a pure "option" would require Bell Atlantic to provide DataCo and/or the Class A shareholders consideration – and thus to give something up in exchange for its exercise.

voting stock, it would still have voting rights through the so-called “Investor Protections.” Coffee Dec. ¶ 25. Indeed, as Professor Coffee showed, it is well-established that options can give the holder the ability to control a corporation. *Id.* ¶¶ 28-29. In short, viewed either as a single interest or decomposed into two separate interests, Applicants would hold financial instruments each of which would give them not only the economic interest, but also the voting power that would make these instruments “equity” even under their tortured reading of the statute.

2. *Applicants' Claim That The Terms In Section 3(1) Should Be Construed In Light Of The Purposes Of Section 271.* Even if Professor Gilson’s view of the purposes of Section 271 were accurate, it would be immaterial. Applicants’ contention that “[t]he Act’s definition of affiliate must be interpreted in light of [Section 271’s] purposes,” BA-GTE *Ex Parte* at 2, is fundamentally mistaken. Section 3(1) is part of the “Definitions” section of the Act. It provides a single, uniform definition of the term “affiliate” that applies simultaneously to numerous provisions of the Act. For example, the term “affiliate” is used in determining dialing parity obligations, 47 U.S.C. § 153, for computing pole attachment rates, *id.* § 224(g); and for determining incumbent LECs’ interconnection obligations, *id.* § 251(c)(2)(C).¹⁸ There can be no separate, “section 271 specific” interpretation of “own” or “equity.” However those terms are interpreted here, they will have to be applied in the same way for each of the dozen or so other provisions to which Section 3(1)’s terms apply.

That principle is underscored by the fact that, where Congress wished to adopt a separate, provision-specific definition of “affiliate,” it did so. For example, in Section 274, which addresses electronic publishing, Congress decided not to use the definition of affiliate contained in Section 3(1) and instead adopted a definition that did not establish affiliation based on “equity (or its equivalent)” or contain a 10 percent safe harbor. *See* 47 U.S.C. § 274(i)(1). Likewise, in Section 273, which addresses manufacturing, Congress modified the definition of affiliate in Section 3(1) such that certain “voting equity interest[s]” in BellCore, which would not be sufficient to establish affiliation under Section 3(1), would establish affiliation for purposes of Section 273. *See* 47 U.S.C. § 273(d)(8)(A). By contrast, Congress did not tailor a separate definition of “affiliate” for Section 271, but instead relied upon the general definition that is applicable throughout Title II.

Moreover, Section 273(d)(8)(A), which establishes the special definition of “affiliate” applicable to the manufacturing restriction, is particularly instructive because in Section 273 Congress showed it knew how to define ownership in terms of “voting equity.” Thus, this

¹⁸ *See also id.* § 223(c) (using “affiliate” in context of regulating obscene telephone calls); *id.* § 228 (c)(7)(D) (using “affiliate” in context of regulating pay-per-call services); *id.* § 228(e)(2) (same); *id.* § 260(b) (using “affiliate” in context of regulating telemessaging services); *id.* § 275(a)(2) (using “affiliate” in regulating ability of BOCs to provide alarm monitoring services); § 275(b) (same).

distinction confirms that Congress' use of the broader term "equity" in Section 3(1) cannot be limited, as Applicants suggest, to include only equity interests have voting power.¹⁹

Finally, Applicants' position that Section 3(1) should be construed in light of the purposes they attribute to Section 271 is incorrect for an additional reason. Under their view, the interpretation of the terms "owned" and "equity" turns on what *services* the "affiliate" will be providing and the claimed competitive situation surrounding those services, so that the Commission would make a fact-specific determination of whether a particular arrangement will enhance incentives to comply with Section 271. *See* BA-GTE *Ex Parte* at 2. Clearly, such an inquiry is totally untethered from the text of either Section 3(1) or Section 271(a). As a matter of plain English, whether one firm is an "affiliate" of another or has an "own[ership]" interest in another, or whether a particular instrument is an "equity interest" or its equivalent, cannot vary based on which services one of the firms provide.

3. *Applicants' Claim That The Securities Laws They Initially Relied Upon Are No Longer Relevant.* For the foregoing reason, the only way to apply the terms "own" and "equity" in Section 3(1) is according to those terms' accepted meaning in the law. In their prior filing, Applicants, through Professor Gilson, claimed that the law establishes a "sharp boundary between an option and an equity security." Gilson Dec. ¶ 17. Professor Gilson provided only one citation for that proposition: SEC Rule 144 under the Securities Act of 1933. According to Professor Gilson, this Rule was highly relevant because it was promulgated "under a regulatory regime more directly concerned with the regulation of securities than the Federal Communications Act." Gilson Dec. ¶ 17.

In its prior *ex parte*, AT&T showed that no such "sharp boundary" exists. *See* AT&T *Ex Parte* at 3-9; Coffee Dec. ¶¶ 12-26. Rather than treat options and equity securities as different, as Professor Gilson maintained, the federal securities laws define the term "equity security" to include "any security, convertible, with or without consideration, into such a security, or carrying any warrant or right to subscribe or to purchase such a security." 15 U.S.C. § 78c. *See also* 17 C.F.R. § 240.16a-4 ("derivative securities and the underlying securities to which they relate shall be deemed to be in the same class of equity securities . . ."). Similarly, Professor Gilson badly misread Rule 144. As Professor Coffee explained, Rule 144 treats convertible securities as the equivalent of the underlying stock into which they are convertible. Coffee Dec. ¶¶ 21-24.

Applicants and Professor Gilson now reverse course. While Professor Gilson concedes that he is not an expert in the securities laws (and that Professor Coffee is), *see* Gilson Supp. Decl. ¶ 16, he nonetheless opines that the securities law citation he initially relied upon, and the other securities law authorities cited by AT&T, are irrelevant to the issues here. According to

¹⁹ Similarly, Congress demonstrated its ability to define affiliation in terms of voting stock in the bankruptcy context. *See* 11 U.S.C. § 101(2) (defining "affiliate" to mean an "entity that directly or indirectly owns, controls, or holds with power to *vote*, 20 percent or more of outstanding *voting* securities of the debtor . . .") (emphasis added).

Applicants and Professor Gilson, this is so because the securities laws are concerned only with mere “disclosure,” and not “control.” BA-GTE *Ex Parte* at 1; Gilson Supp. Dec. ¶ 6.

As an initial matter, it is Applicants’ argument that is irrelevant because it is premised on their flawed supposition that only equity that provides control is relevant for purposes of Section 3(1). *See supra* pp. 6-11. In any event, as Professor Coffee explains, Applicants were right the first time when they argued that the Commission should look to the securities laws for guidance in construing the term “equity.” Coffee Supp. Dec. ¶¶ 3-14. Contrary to Applicants’ more recent claims, the securities laws are directly concerned with how and whether holders of “equity securities” can use those securities to “control” corporations. *See* L. Loss & J. Seligman, *Securities Regulation* 1691 (3d ed. 1990) (“The concept of ‘control’ of a corporation or other entity pervades the statutes administered by the SEC.”).

As Professor Coffee explains, Applicants’ claim that the federal securities laws are aimed only at “prohibiting insider trading, assuring disclosure, and preventing fraud” is “woefully inaccurate.” Coffee Supp. Dec. ¶ 1. Rather, “[t]he definition of ‘control’ under the federal securities laws developed in a context where the SEC was not seeking to prevent fraud or assure disclosure, but rather to prevent ‘circumvention’ (in Professor Gilson’s phrase) of the SEC’s substantive [regulatory] authority.” *Id.* ¶ 6. Thus, the SEC has repeatedly looked beyond corporate formalisms to economic realities to prevent companies from evading its substantive regulations. *Id.* ¶¶ 6-9. And is so doing, “the SEC has found that options and convertible securities can convey control.” *Id.* ¶ 7. In short, “the SEC developed its definition of ‘control’ in the context of statutes unrelated to disclosure, insider trading, or anti-fraud concerns, in order to prevent circumvention of statutory policies that required that the SEC make affirmative findings about whether the controlling company should be permitted to operate the controlled company in the public interest.” *Id.* ¶ 12.

Professor Coffee also demonstrates why Professor Gilson is incorrect in dismissing the Rules the SEC issued pursuant to Section 16(b) of the Securities and Exchange Act of 1934 as irrelevant on the ground that it deals with mere “insider trading.” *See* Coffee Supp. Dec. ¶ 9. Congress provided in Section 16(b) that its *per se* rule against “short swing profits” would apply to 10 percent shareholders because Congress assumed that 10 percent shareholders would have sufficient power and influence to give them access to inside information. In implementing this provision, the SEC held that options and other derivative securities would count towards the 10 percent ownership threshold because holders of these securities would have the same level of influence as entities that held the underlying securities themselves. *Id.* Thus, the SEC’s rule reflects a “finding about the meaning of ‘control,’ not the need for full disclosure.” *Id.* *Accord, Morales v. Freund*, 163 F.3d 763, 765 (2d Cir. 1999) (observing that a “core object of § 16(b)” is to prohibit “short-swing profit by investors who trade in stocks whose value they may be able to influence”).²⁰

²⁰ Oddly, while claiming that federal securities laws are irrelevant as to the meaning of the terms “equity” and “control” in Section 3(1) – even though those laws define those terms – Applicants

(continued . . .)

In all events, the Commission has stated that Congress' definition of "equity securities" is relevant to control. The securities laws require any person that acquires more than 5 percent of any class of "equity security" to disclose that acquisition. *See* 17 U.S.C. § 78m(d). The purpose of this provision is to alert investors to a potential change in control of the corporation. *SEC v. Savoy Indus., Inc.*, 587 F.2d 1149 (D.C. Cir. 1978). In its *Cable Attribution Order*, the Commission relied on this provision in establishing its cable attribution rules stating that the securities law requirement shared the "attribution rule's goal of identifying interests which confer on their holders the potential for influence or control." *Cable Attribution Order* ¶ 49.²¹

4. *Applicants' Claim That Commission Rules Support Their Position.* Applicants' initial assertion that Commission precedent supports their claim that "future interests" like "options and other conversion interests do not count as ownership," Supp. Filing at 36-37, was defended by creatively editing their quotations of Commission precedent, relying (without saying so) on old rules that have been superseded by new rules that foreclose their approach, and citing the Cable Bureau's summary of Bell Atlantic's own comments as "Commission precedent." These stark inaccuracies have been described in detail in AT&T's prior filings. *See* AT&T Opp. at 14-18; AT&T *Ex Parte* at 6-8. Nonetheless, Applicants continue to claim that the Commission's *Cable*

(... continued)

persist in claiming that state corporate law cases are relevant to the "purposes" of Section 271 for the purpose of determining "ownership." BA-GTE *Ex Parte* at 9 n.4. In all events, there is a reason why Applicants have consigned their discussion of these cases to a footnote. For example, both *Martin v. Schindley*, 442 S.E.2d 239, 240-41 (Ga. 1994) and *Thacher v. Weston*, 83 N.E. 360, 361 (Mass. 1908) construe state real estate law, not state corporate law. Similarly, *Webb v. R.O.A.* 773 P.2d 834, 838-89 (Utah Ct. App. 1989) was a contract case in which the court sought to determine whether the parties "intended" by contract to transfer stock in a corporation upon exercise of an option or to have title to those shares transferred at a subsequent date. And it is ironic that Applicants would cite the decision of the intermediate appellate court in Tennessee in *Ball v. Overton Square*, 731 S.W.2d 536 (Tenn. Ct. App. 1987), to support their position here. In *Overton Square*, while the Court held that an option to acquire stock did not confer "legal title" over that stock, it did not disagree with the trial court's holding that the option gave its holder "control" over the firm.

Applicants' attempt to revive the one federal case they cited – *Nerken v. Standard Oil Co.*, 810 F.2d 1230 (D.C. Cir. 1987) – is unintelligible. *See* BA-GTE *Ex Parte* at 9 n.4. As AT&T explained in its *ex parte* filing (at 5 n.3), *Nerken* involved the construction of a contract which "narrowed" the concept of ownership for purposes of the transaction to "outstanding common stock" and the Court thus concluded that it was irrelevant whether a prospective right to own stock is ownership under the law generally. *Id.* at 1232.

²¹ AT&T disagrees that the cable attribution rules share the same goals as the SEC disclosure rule, but the Commission could not consistently with its cable attribution rules decisions determine that the federal securities laws are irrelevant here.

Attribution Order and *Broadcast Ownership Order* endorsed their position that convertible interests do not count for purposes of ownership. BA-GTE *Ex Parte* at 13-16. That claim remains untrue.

As AT&T explained, in the regulation the Commission adopted to implement its “equity-debt” rule in the cross-ownership context, 47 C.F.R. § 76.501, the Commission created a significant exception to the general rule (contained in Note 2(e)) that holders of “instruments such as warrants, convertible debentures, options or other non-voting interests with rights of conversions to voting interests shall not be attributed unless and until converted.” It made that rule subject to Note 2(i), which provides that, notwithstanding Note 2(e):

the holder of an equity or debt interest or interests in an entity covered by this rule shall have that interest attributed if the equity (including all stockholding, whether voting or nonvoting, common or preferred, and partnership interests) and debt interest or interests, in the aggregate, exceed 33 percent of the total asset value (all equity plus all debt) of that entity.

It would make no sense for the Commission in Note 2(e) to list specifically convertible instruments as subject to Note 2(i) if these instruments were excluded altogether from the scope of Note 2(i). Rather, if that is what the Commission wished to do, it would simply have omitted convertible instruments from Note 2(e) altogether or noted that they were never attributable until conversion is affected.

Applicants can arrive at their counterintuitive reading of these provisions only by arguing that the specific instruments listed in the parenthetical after “equity” are exhaustive. See BA-GTE *Ex Parte* at 14 (claiming rule 2(i) “enumerate[es] exactly those ‘equity’ interests that are subject to aggregation with debt” – “stockholdings, whether voting or nonvoting, common or preferred, and partnership interests.”). But they are not. Rather, as the use of the term “including” makes plain, they are only illustrative examples of equity interests. Indeed, as noted above (pp. 7-8), Applicants themselves acknowledge the existence of other forms of equity not included on this list, such as certain instruments nominally styled as debt.

As AT&T also explained, Applicants tortured reading of the equity plus debt rules is flatly contradicted by the Commission’s discussion in the *Cable Attribution Order* itself. There, the Commission addressed the claim by Time Warner that a company is an “affiliate” of a LEC where the LEC holds only “options, warrants, and convertible debentures” to purchase voting stock in that company. *Id.* ¶ 129 n.329. The Commission determined that it would use its equity plus debt rule in determining whether a company is an “affiliate” of a LEC. *Id.* ¶ 129. And in explaining how this rule would work where the LEC holds “options, warrants and convertible debentures,” the Commission observed:

We do not believe that these types of securities demonstrate the type of current, active participation by a LEC envisioned by the LEC test, *unless the amount of these securities that an investor holds is more than 33% of the total assets of a company.*

Id. ¶ 129 n.329 (emphasis added). Having earlier pretended the italicized passage did not exist, Applicants now say it is “ambiguous.” BA-GTE *Ex Parte* at 14. There is no ambiguity. It could not be clearer that the Commission found that – contrary to Applicants’ claims – an “affiliation” relationship can be established when a BOC hold options in another company.

Applicants last ditch defense is that if options count under the Commission’s “equity-debt” rules, it is only because the Commission considered them to be debt. BA-GTE *Ex Parte* at 14. There are three independent dispositive flaws in that claim. *First*, this argument is based on Applicants’ erroneous view that the specific instruments listed in the parenthetical after “equity” are exhaustive. *See id.* *Second*, Applicants make no attempt to show how options – which are uniformly treated as equity under the federal securities laws and which Applicants even characterize as “future equity” – could be considered “[a] fixed and certain obligation to pay money.” Black’s Law Dictionary (7th ed. 1999) (defining “debt”). *Third*, one of the core purposes of the “equity plus debt” rule is to determine when one entity has sufficient control over another entity to create attribution. *Cable Attribution Order* ¶ 83. Even if the Commission had concluded that the convertible equity instruments here are debt for these purposes, the rule would still mean that possession of such instruments, when in excess of 33 percent of the value of the company, constitute “control” – which, under Section 3(1), creates an “affiliate” relationship.

Applicants also dispute that the statutory definition of “affiliate” the Commission interpreted in the *Cable Attribution Order* to include convertible instruments (which is set forth in 47 U.S.C. § 522(2)) is *narrower* than Section 3(1). Tellingly, Applicants have nothing to say about the text of those provisions or the Commission’s discussion of these provisions in its *Cable Attribution Order*. There, the Commission observed that Section 522(2)’s definition of “affiliate” is much narrower than Section 3(1) because unlike the former provision, the latter includes both “direct” and “indirect” ownership and interests that are the “equivalent” of an equity interest. *Cable Attribution Order* ¶¶ 159-61.

And as to Applicants’ claim the “LEC test’s” purpose is significantly broader than “that animating Section 3(1)’s definition of affiliate,” BA-GTE *Ex Parte* at 15, that argument is both ironic and wrong. It is ironic because when Applicants’ initially claimed that the Commission’s discussion of the LEC test supported their position, they asserted that this rule was pertinent because it served the same purpose as Section 271. *See Supp. Filing* at 37. It is wrong because, as explained above, the interpretation of a statutory definition cannot depend upon the claimed “purpose” of only one of the many substantive provisions in which the defined term subsequently appears.

Applicants also claim that AT&T has failed to respond to Applicants’ prior argument that the *Broadcast Attribution Order* “squarely follows the general rule that ‘nonvoting instruments such as options or warrants’ are not attributable.” BA-GTE *Ex Parte* at 12 (citing *Broadcast Attribution Order* ¶¶ 2 n.4, 26 n.66). AT&T has in fact responded to this argument and demonstrated its inaccuracy. *See AT&T Opp.* at 15. In light of Applicants’ repetition of the claim, we will do so again.

In the passages quoted by Applicants, the Commission was summarizing the pre-existing rules that were in effect prior to this rulemaking, *not* the rules it was adopting to replace them.

Thus, for example, in Paragraph 26, note 66 of the *Broadcast Attribution Order*, on which Applicants rely, the Commission observed that “[p]ursuant to the current attribution rules” “nonvoting stock, other nonvoting instruments such as options or warrants, and debt” are “unattributable,” and cited 47 C.F.R. § 73.3555 Note 2(b) & (f) for that proposition. But as AT&T explained in its Opposition (at 15), the *Broadcast Attribution Order* “review[ed]” and “amend[ed]” those existing rules. *Broadcast Attribution Order* ¶¶ 1-2, 35-36. Thus, in the rules it promulgated in its *Broadcast Attribution Order*, the Commission *amended* Note 2(f) – which had contained the existing general rule that convertible interests were not attributable – by adding the caveat that this rule was now “[s]ubject to paragraph (j) of this Note.” And in Note 2(j), the Commission adopted the same principle that it employed in the *Cable Attribution Order* – that, regardless of label, any interest, including options, that in the aggregate exceeds 33 percent of the value of the company would be considered attributable.

That Applicants have incorrectly cited the Commission’s summary of its old (and now superseded) rules is also demonstrated by the fact that in the cited passages the Commission listed the following instruments as “unattributable”: “nonvoting stock, other nonvoting instruments such as options or warrants, and debt.” See *Broadcast Attribution Order* ¶¶ 2 n.4; 26 n.66. But this cannot be a description of the Commission’s current rules because even Applicants concede that nonvoting stock and debt are now attributable under the Commission’s new equity-debt rule. See *BA-GTE Ex Parte* at 14. Applicants must recognize that, for they took pains to edit out from their quotation the words “nonvoting stock” and “and debt.” Cf. *id.* at 12.

Finally, Applicants fail to explain why the Commission’s five percent voting equity benchmark for control should not apply here. As AT&T explained in its *ex parte* filing (at 8 n.8), the Commission has repeatedly found in both the cable and broadcast contexts that holding more than 5 percent of the voting stock of a company gives the investor “control” over that company. *Broadcast Attribution Order* ¶ 10; *Cable Attribution Order* ¶¶ 45-50. Here, Bell Atlantic would have more than double that threshold. Applicants say that application of this rule “is foreclosed by the plain language of section 3(1), which expressly permits the owning of any equity interest up to 10% (whether voting or nonvoting).” *BA-GTE Ex Parte* at 16. That is wrong. By its plain terms, the statute only permits a BOC to acquire up to a 10 percent “equity” interest in a company if that interest does not also give “control.” Simply because a 10 percent voting interest is not ownership under the statute does not mean that this interest automatically passes the control test too, and the Commission takes the view that 5 percent voting interest automatically gives control. Further, it is easy to harmonize the two provisions once it is recognized that an “equity” interest is not synonymous with the voting stock that is the focus of the Commission’s rule. There are numerous other equity interests that BOCs can acquire without triggering the Commission’s 5 percent equity voting threshold for control, such as preferred stock and limited partnership interests.

5. *Applicants’ Claims Regarding The MFJ Precedent Upon Which They Initially Relied.* Applicants now give short shrift to the MFJ precedent that they initially claimed constituted “[a] significant body of relevant legal precedent.” They now consign that “significant body of relevant legal precedent” to a single footnote. *BA-GTE Ex Parte* at 15 n.8.

They have radically de-emphasized this claim because application of the precedents that they initially cited would be fatal to their position. While the MFJ court did allow NYNEX to purchase a conditional interest in a concern that would provide interexchange services in the future, the court expressly rejected the suggestion that options or other conditional interests could never create affiliation. *Tel-Optik Case*, slip op. at 3-4. See also *United States v. Western Elec. Co.*, Civ. Action No. 82-192, slip op. at 3-4 (D.D.C. Jan. 31, 1992) (this Court has “rejected the . . . argument that no waiver or Department approval [is] required prior to a Regional Company acquiring a conditional interest in a prohibited line of business”). Rather, the Court opined that “manipulations of form should not obscure the real economic incentives underlying . . . [a particular business] relationship.” *Tel-Optik Case*, slip op. at 3 (citation omitted).

Accordingly, the MFJ court determined that a BOC’s purchase of a conditional interest in a company providing interexchange services would constitute a “real economic interest” unless the BOC could demonstrate that: (1) the investment in the conditional interest was minor; (2) the exercise of the conditional interest was genuinely in doubt; and (3) the interest would give the BOC no ability or incentive to discriminate. *Tel-Optik*, slip op. at 5-7. And as AT&T explained in its Opposition (at 18-19), the interest that Bell Atlantic would acquire in DataCo fails all three requirements. That is why Applicants reversed course and argued that “no authority requires the Commission to apply the same factors Judge Greene developed under the MFJ” Response at 13. While that is true, the existence of this MFJ precedent is fatal to Applicants’ initial claim that the MFJ precedent supported their assertion that there is a fundamental principal of law that convertible interests are never considered equity.

Tellingly, Applicants do not even cite the *Tel-Optik Case* in their latest filing, but instead rely on a Department of Justice (“DOJ”) Report pertaining to the acquisition of a conditional interest by SBC. See BA-GTE *Ex Parte* at 15 n.8. Applicants seem to suggest this case supports their claim that investments that give a BOC only a “passive” economic interest in an interLATA carrier are irrelevant because SBC could have exercised the conditional interest it held by making only a nominal payment – *i.e.*, the amount of the payment did not change as the underlying assets either increased or decreased in value. *Id.* As an initial matter, this report cannot serve as precedent because, contrary to Applicants suggestions, *id.*, the MFJ court never approved the conditional interests at issue in this report. Challenges to that report were still pending at the time the decree was dissolved. AT&T Opp. at 19 n.18. Further, in the report cited by Applicants, the DOJ applied the *same* three-part test developed by the MFJ court that Applicants say should not be followed now. See *id.* And, unlike the conditional interest that would be acquired by Bell Atlantic here, the conditional interests found acceptable by the Department easily satisfied the three *Tel-Optik* standards. For example, the investment necessary to acquire the contingent interests in this case was \$1.5 million – a tiny fraction of Applicants’ investment here. See Letter from Liam Coonan to Barry Grossman, at 3 (Apr. 6, 1988) (“Coonan Letter”), attached to Report of the United States Concerning the Proposed Retention of a Conditional Interest by Southwestern Bell Corp., Civ. Action No. 82-192 (D.D.C. Apr. 15, 1988) (“SBC Report”). Likewise, the conditional interest SBC was acquiring could only be exercised if SBC were able to convince the MFJ court that ownership of a company that engaged in research, development and sale of customer premises equipment was lawful under the decree. See Coonan Letter at 1-2.

Finally, because SBC had an option to purchase only a small, minority interest in the company in question, its incentive to discriminate were attenuated. *See* SBC Report at 1 n.1.

Control

While Applicants join issue with AT&T on the ownership inquiry, they largely ignore AT&T's control analysis. Not once in their filing do they respond to Professor Coffee's extensive analysis showing that Bell Atlantic would in fact control DataCo. *See* Coffee Dec. ¶¶ 27-37. As Professor Coffee explained, there is well-developed case law addressing what constitutes "control" of a corporation, and the factors that establish control in those cases are present here. Indeed, as Professor Coffee described, control has been found in the case of an option arrangement analogous to Applicants' proposal. *See* Coffee Dec. ¶ 29 (discussing *SEC v. Cavanaugh*, 1 F. Supp.2d 337 (S.D.N.Y. 1998)).

Nor do Applicants have anything to say about one of the most significant means by which they will exercise control over DataCo – filling key DataCo management positions with existing Bell Atlantic and GTE employees who will know that Bell Atlantic will be formally reacquiring DataCo in a few years and whose professional future will depend upon Bell Atlantic's attitude towards them. It defies common sense to suggest that DataCo's managers would advocate any policy contrary to Bell Atlantic's interest.

Recent developments confirm that DataCo employees would be under Bell Atlantic's thumb. The day after Applicants submitted their Supplemental Filing, Bell Atlantic and GTE issued a press release describing the structure the combined companies would take.²² Among the units they would create is the Internetworking, Information and International unit, which would be headed by Michael Masin (currently Vice Chairman of GTE). And reporting to Mr. Masin will be Paul Gudonis (currently head of GTE Internetworking) and Joseph Farina (currently head of Bell Atlantic's Data Solutions Group) – the individuals that Applicants have stated they are placing in charge of DataCo. Thus, at the same time Applicants are claiming that they will not control DataCo, Applicants have made clear that DataCo's managers will *report* to senior Bell Atlantic officials and will be firmly in the chain of command.

In short, it is clear that under Applicants' proposal there is no substantive difference in the operations of DataCo than if it were formally part of Bell Atlantic-GTE. Paul Gudonis would stay at his same desk (which would be leased from Bell Atlantic pursuant to a "commercially reasonable" contract), would continue to report to his current superior (Michael Masin), and would supervise a work force composed of Bell Atlantic and GTE employees. The only thing that would change is the name that appears on checks that Mr. Gudonis and other employees of DataCo would receive (although payroll would presumably continue to be administered by Applicants pursuant to yet another "commercially reasonable" contract).

²² *Bell Atlantic and GTE Designate Senior Executives for Merged Company* (Jan. 28, 2000) (<http://www.ba.com/proactive/newsroom/release.vtml?id=19234>) (attached hereto at Tab B).

To the extent Applicants do respond to AT&T's analysis, their arguments are wide of the mark. First, Applicants claim that the Commission need not worry that Applicants will select the entire Board because the Directors will have fiduciary duties to the public shareholders. *Ex Parte* 16. But as Professor Coffee explained, that argument proves too much. Coffee Dec. ¶ 34. It would apply equally if each DataCo Director were a Bell Atlantic employee. And clearly there is no basis for claiming that a corporation whose entire Board was made up of Bell Atlantic employees was independent of Bell Atlantic. *Id.* Further, given the way in which Applicants have shackled DataCo by restricting that company from engaging in a wide-range of activities absent Bell Atlantic's consent and making it dependent upon Bell Atlantic for key support services, AT&T *Opp.* at 23-27; AT&T *Ex Parte* at 9-11, it would quite often be in the public shareholders' economic interest for DataCo to take actions that also advance the interests of Bell Atlantic.

With regard to the wide range of areas in which Applicants have arranged to have Bell Atlantic supply support services to DataCo pursuant to "commercially reasonable" contracts, Applicants say there is no need to worry that these contracts will give Bell Atlantic control because DataCo can terminate them. *BA-GTE Ex Parte* at 17-18. But if DataCo does not have the ability to perform these important functions (because GTE did not transfer the necessary assets to DataCo) and if Bell Atlantic can block DataCo from acquiring the necessary assets (through its "investor safeguard" controls), DataCo would obviously be in no position to perform these services itself. Moreover, given that DataCo's managers understand that DataCo would soon be formally folded into Bell Atlantic, it would make no economic sense for DataCo to acquire the assets necessary to be able to function as a stand alone company if it can obtain the necessary support services from Bell Atlantic.

In this regard, Applicants also attack a strawman regarding AT&T's argument that the "commercially reasonable" contracts envision Bell Atlantic providing R&D for DataCo. Applicants say BBN Technologies, which will not be transferred to DataCo, largely does R&D for the government so the fact that it is not being transferred to DataCo is of no moment. *See BA-GTE Ex Parte* at 18 n.9. Even if Applicants description of BBN Technologies is accurate, Applicants have missed the relevant issue. The question is whether DataCo will have its own R&D capability, or whether it will have to rely on Bell Atlantic for this critical component of its business. As to that point, Applicants are silent. Likewise, Applicants do not explain how DataCo could function independently of Bell Atlantic if, as it appears, DataCo will have to rely on Bell Atlantic for managing its network capacity.

Applicants could, of course, confirm the precise nature of the "commercial contracts" and "investor safeguards" by providing the actual documents to the Commission, rather than have their lawyers make vague assertions about what those documents actually say. The failure to do so is another reason why Applicants' current proposal cannot be approved. As the Commission's recent *Qwest-US WEST Order* makes clear, the Commission cannot find that a proposed "divestiture" complies with Section 271(a) until the exact details of the plan are made public. In the *Qwest-US WEST* proceeding, the Commission was concerned that the so-called "support functions" *Qwest-US WEST* were going to be providing the "buyer" of *Qwest's* long distance customers would effectively make *US WEST* a "provider" of interLATA services in violation of Section 271(a). Accordingly, the Commission required *Qwest* and *US WEST* to detail "the terms

of the divestiture sale, the customer support and other functions to be provided by Applicants, as well as the term sheets and contracts themselves.” *Qwest-US WEST Merger Order* ¶ 25.

Similar concerns are raised here. As noted, like Qwest-US WEST, Applicants propose to enter into numerous contracts with DataCo regarding “support functions” they will provide to DataCo – e.g., joint marketing, R&D and network capacity management. See Supp. Filing, App. B. Applicants have filed four pleadings on these issues to date but have yet to disclose these contracts. Further, Applicants have not filed any of the principal documents that would govern the “divestiture,” including *inter alia*, the prospectus governing the public offering, the “Investor Safeguards” that would restrict DataCo from engaging in many normal corporate activities, the contract that would determine what assets would be transferred to DataCo, DataCo’s corporate charter and by-laws, or provisions of the Class A and B shares that would govern the rights of the holders of those securities.

* * *

Two final points warrant mention. *First*, construction of the Act that Applicants propose obviously could not be confined solely to Applicants’ transaction. Rather, it would allow BOCs to flout the requirements of Section 271 generally. Section 271 makes no distinction between interLATA data and voice services, so Applicants’ interpretation of Section 3(1), if adopted, would equally allow a BOC to acquire the same type of controlling interest in a voice long distance carrier. Thus, for example, Qwest and U S WEST would surely reconsider the need to effectuate a “final and irrevocable divestiture” of Qwest’s long distance assets, and could instead simply replicate the type of relationship that Applicants would establish here. Moreover, these principles would apply not only when a BOC is seeking to comply with divestiture requirements, but also when it wishes to acquire something new. Thus, for example, BellSouth could enter the interLATA market by acquiring interests in a long distance carrier comparable to what Bell Atlantic and GTE seek to retain here.

And this approach would warp not only the application of Section 271, but all the provisions of the Act that use the term “affiliate” and that rely on Section 3(1)’s definition. As Professor Coffee explains, the whole point of extending these numerous restrictions to affiliates of the regulated entities as well as to the regulated entities themselves, and of defining “affiliate” in terms of “ownership” and control” whether “direct” or “indirect,” is to prevent “artful maneuvers” to evade the Act’s regulatory requirements and the Commission’s jurisdiction. Coffee Supp. Dec. ¶ 2. If the Commission were to adopt Applicants’ formalistic test, “this form of loophole could quickly become a triumphal arch through which talented lawyers could march a broad variety of transactions so as to avoid FCC scrutiny.” *Id.* ¶ 13. For example, as Professor Coffee explains, “the predictable next step” is to “park” the Class A shares with a cooperative investment banking firm that would be happy to serve as the “token equity shareholder for a fee” or to put assets in shell corporations in which the parent holds a debt interest with a right to convert into equity. *Id.* ¶ 14.

Second, the numerous defects in Applicants’ proposal are highlighted by the fact that there exist other corporate structures that they could have utilized which would raise significantly fewer concerns under Section 271(a) and would achieve the claimed “benefits” to which Applicants

repeatedly refer. For example, rather than make their Class B shares convertible with no payment, Applicants could make exercise of the conversion right contingent upon paying the Class A shareholders compensation based on the market value of the piece of DataCo they would be formally gaining. Alternatively, Bell Atlantic could acquire all of GTE but the interLATA data assets, plus the right to acquire these assets at the prevailing market price after gaining the necessary Section 271 authorizations. These types of arrangements would enable the merged entity to acquire the assets when it is lawful for it to operate them, but any increase in the value of DataCo during the period before that is lawful would be captured by the public shareholders, not Bell Atlantic. Of course, in addition to addressing the "ownership" issues, Applicants would also have to eliminate the control mechanisms they have built into this proposal – including the "Investor Safeguards," the web of contracts on essential matters, the 10 percent cap on other shareholders' voting interests, and the right to pick the initial Board of Directors. But Applicants appear to be attempting to present the Commission with a "take it or leave it" option. If so, the law permits only one response.

Yours truly,



Peter D. Keisler



AL STAFF (CAL) 866220010 ED311 RECV11D

BEL: OUTLINES DATA STRATEGY AT QUARTERLY ANALYST MEETING;
RESPONSE TO LD OFFERING OUTPACING TARGETS; BAM FORECASTS
CONTINUED STRENGTH; STRONG BUY

04:16pm EST 3-Feb-00 Prudential Securities (G.WOODLIEF 212-778-8411) BEL GTE

RESEARCH NOTES

February 3, 2000

Subject: BELL ATLANTIC (BEL-59 5/16)--NYSE
OPINION

Current: STRONG BUY

Analysts: Guy W. Woodlief (212)778-8411
Susan Lynner (703) 276-0055 RISK: LOW

12-Month Price Target: \$76

Ind. Div.: \$1.54 Yield: 2.60% Shares: 1,585 mil. 52-Wk. Range: 70-51

| EPS | FY | Year | P/E | 1Q | 2Q | 3Q | 4Q |
|---------------|----------|-------|-----|----------|----------|----------|----------|
| Actual 12/98 | \$ 2.72A | | | \$ 0.66A | \$ 0.68A | \$ 0.69A | \$ 0.69A |
| Actual 12/99 | \$ 3.01A | 19.7X | | \$ 0.73A | \$ 0.75A | \$ 0.76A | \$ 0.77A |
| Current 12/00 | \$ 3.35E | 17.7X | | \$ 0.81E | \$ 0.83E | \$ 0.85E | \$ 0.86E |
| Current 12/01 | \$ 3.70E | 16.0X | | | | | |

Highlights:

* Bell Atlantic held their quarterly analyst conference today. The company addressed issues related to slow DSL provisioning in 1999 and outlined their strategy for accelerating the roll out in 2000. A data services subsidiary will be operational by July 1. The company expects to meet target of 500,000 subscribers by year end 2000.

* BEL announced consumer enthusiasm for the NY long distance offering. Management said they will meet or possibly exceed 1 million residential customer target. Management expects other state filings to occur by year-end.

* Denny Strigl, President and CEO of the Global Wireless Group, expects strong wireless industry growth with 70%+ penetration in the US by 2009. BAM expects growth rate improvement in 2000 for revenue, operating income, and EBITDA. Management expects post GTE/Vodafone/ALLTEL subscriber base of 27 million by year end 2000 with revenue in the \$14.5-\$15.0 billion range.

* More details emerged regarding the proposed spin-off of GTE-I as a condition for FCC approval. BEL/GTE expects to recognize 80% of the income from the newly spun-off unit as a separate line item on its own income statement.

Investment Opinion

We rate Bell Atlantic a Strong Buy with a \$76 price objective. The proposed merger with GTE (GTE, 71, rated Hold) should create a national footprint with the size and scope to compete on a global scale. We believe the merger could win final regulatory approval around mid-year 2000.

Additional Information

BEL Expects To Quickly Ramp DSL Deployment In 2000, Installs Should Reach 3,000 Per Day By Year End Up From 1,300 Per Week Today. BEL cited a slower than expected CO upgrade and delays in ISP agreements as the primary reasons for the disappointing 1999 DSL subscriber levels. At year end, BEL had 317 COs ready for sales, as of today, that number is 574. An electronic ordering interface has been established with America Online and is expected to rapidly advance subscriber growth. BEL announced that they expect to have 1,200 COs ready by YE00 with 22 million qualified lines up from 8 million qualified lines at YE99. Management announced that they are adding DSLAM capacity in every CO. They also announced that they are upgrading remote terminals to allow expansion of qualified lines and loops giving them the ability to offer ADSL directly from the remote terminal. They expect that 80% of installs can be done without a truck roll. Management also announced a major marketing campaign with aggressive direct and mass marketing to the retail consumer, and wholesale distribution through over 60 ISP agreements. BEL has created a Data Services subsidiary with a dedicated management team with compensation tied to performance.

New York Long Distance Launch Has Been "Exceptional" Ahead Of BEL's Internal Target For January Sales. BEL has received 3x expected volume through the Internet channel and 2x the expected in-bound marketing volume. Support operations and network are said to be performing as expected. The LD business product is expected to launch in March targeting small and medium-sized businesses. The residential marketplace has responded favorably to single bills, packaged offerings, and pricing plans. Tom Tauke mapped plans for LD applications through 2000, including Massachusetts, Pennsylvania, New Jersey, and Virginia, with filings for smaller states (CT, NH, VT, RI, ME) piggybacking on the larger states with similar OSS systems.

The Wireless Group Announced A Bullish Growth Forecast And 2000 Initiatives Including The Single Rate USA Plan Expected To Roll-Out Upon Completion Of The Vodafone Merger. Other major initiatives for 2000 include bundled offerings and a wireless data push. BEL expects to have four new data-capable handsets by the end of 2Q00. Management announced plans for 3G roll-out and said that their infrastructure is backward compatible so that new 3G handsets will operate on the current infrastructure. BEL also indicated that it will continue to invest in and sell CDPD as its always-on service is in demand. Management said that

their agreement with OnStar should yield 4 million customers over the next three years. The formation of "WirelessCo" (BEL/GTE/Vodafone) is moving forward with overlap disposition ongoing, a senior team named, and operational integration plans in place.

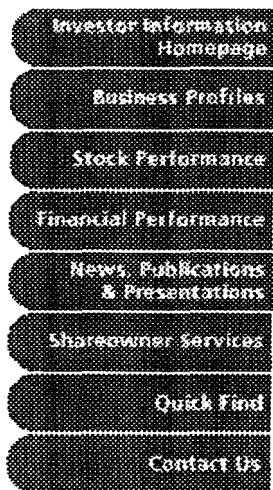
Although BEL/GTE Will Hold An Initial 10% Equity Interest, The Company Will Recognize 80% Of Income From The Proposed GTE-I Spin-Off. Tom Tauke, EVP for External Affairs, estimated FCC approval in April (rather than earlier 1Q predictions). He said that, in addition to questions over the spin-off proposal likely to be raised in the upcoming comment period, he anticipated that details of relations between the merged BEL/GTE (NewCo) and the GTE-I spin-off (DataCo) would likely loom large in discussions with the FCC.

BEL Expresses Confidence In Achieving Wall Street's Expectations. BEL is targeting 6% revenue growth for 2000. Second half of the year should outpace the first. The company expects that EPS as will grow in the 10-12% range. As a combined entity, BEL/GTE/Vodafone forecasts year one revenue growth of 7% accelerating to 8-10% over three years. EPS of the combined company will grow in the single digits year one ramping to 15%+.

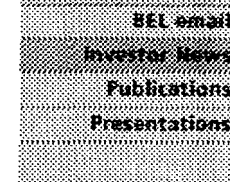
Copyright (c) 2000 First Call Research Notes
Received by NewsEDGE/LAN: 2/3/2000 4:28 PM

B





News, Publications & Presentations



Bell Atlantic and GTE Designate Senior Executives For Merged Company

Bell Atlantic and GTE today further defined the structure of the company they are forming through their merger by designating 23 senior executives for leadership positions in key business units and corporate organizations.

The designations take effect upon completion of the merger, which the companies aim to conclude around the end of the first quarter.

Telecom

The new company's telecom business, the largest in the U.S., will be led by the following executives, who will report to Lawrence T. Babbio, designated vice chairman and president:

- Frederick D. D'Alessio, Bell Atlantic group president - consumer services, will be president - advanced services, overseeing long distance, digital subscriber line services, competitive local exchange activities, web hosting and video services.
- Bruce S. Gordon, Bell Atlantic group president - enterprise business, will be president - retail markets, with responsibility for consumer and general business customers.
- Paul A. Lacouture, Bell Atlantic group president - network services, will be president - wholesale markets, with responsibility for sales and services to wholesale customers, and for all network technology and engineering.
- Eduardo R. Menasce, chairman and CEO of CTI, GTE's wireless venture in Argentina, will be president - enterprise solutions, focusing on large business customers and strategic accounts.
- Eileen O. Odum, regional president - Northwest for GTE, will be president - national operations, with responsibility for all aspects of service provisioning and customer care.
- Doreen A. Toben, Bell Atlantic vice president and controller, will be senior vice president and Telecom CFO.

Internetworking, Information Services and International

Reporting to Michael T. Masin, designated president and vice chairman, will

be leaders of GTE Internetworking and the new company's information services and international operations:

- Paul R. Gudonis will continue as president of GTE Internetworking, GTE's Internet backbone and data services business. Reporting to Gudonis will be Joseph C. Farina, president and CEO of Bell Atlantic's Data Solutions Group, who will be executive vice president and COO, and Daniel P. O'Brien, GTE executive vice president - Finance and CFO, who will be executive vice president and CFO.

Under a proposal filed with the FCC on Jan. 27, upon the close of the merger GTE Internetworking will become an independent company with public shareholders, and Gudonis will become CEO.

- Katherine J. Harless, president - GTE Airfone, will be president - information services, with responsibility for directory publishing and online services.

- Thomas A. Bartlett, Bell Atlantic president and CEO - international wireless, will become president - global network and transport solutions, with responsibility for international connectivity and long distance.

- Daniel C. Petri, Bell Atlantic president - international telecommunications, will be president - International, Europe/Asia.

- Fares F. Salloum, GTE senior vice president - international operations, will be president - International, The Americas.

- Alfred C. Giammarino, GTE senior vice president - international finance, will be senior vice president and CFO for Masin's group.

Wireless

The companies also named the leaders of the national wireless business being formed through the Bell Atlantic-GTE merger and the combination of the U.S. wireless assets of Bell Atlantic and Vodafone AirTouch. They will report to the venture's designated president, Dennis F. Strigl:

- Lowell C. McAdam, president and CEO of PrimeCo Personal Communications, will be executive vice president and COO.

- Edward Langston, CFO of the USA/Asia Pacific region for Vodafone AirTouch, will be vice president and CFO.

- Richard J. Lynch, executive vice president and Chief Technical Officer for Bell Atlantic Mobile, will hold the same position in the new company.

Corporate Leadership

Two of the senior executives designated today will report directly to Charles R. Lee and Ivan Seidenberg, who will be co-CEOs of the new company:

- James A. Attwood, GTE executive vice president - strategic development and planning, will be executive vice president - strategy, development and planning.

· Mary Beth Bardin, GTE senior vice president - public affairs and communications, will be executive vice president - public affairs and communications.

Reporting to Frederic V. Salerno, designated vice chairman and CFO, will be:

* William F. Heitmann, Bell Atlantic acting treasurer and vice president - asset management, will be vice president and treasurer.

* Lawrence R. Whitman, GTE vice president - finance and planning, will be vice president and controller.

* John F. Killian, Bell Atlantic vice president - investor relations, will hold the same position in the new company.

Thomas J. Tauke, Bell Atlantic senior vice president - government relations and acting executive vice president - external affairs and corporate communications, will be senior vice president - public policy and external affairs, reporting to William P. Barr, executive vice president and general counsel of the new company.

###



[Homepage](#) [For Your Home](#) [For Your Business](#) [For Government](#) [About Us](#) [Privacy](#)

Copyright © 2000 Bell Atlantic Corporation

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC, 20554**

| | | |
|------------------------------------|---|----------------------|
| In the Matter of |) | |
| |) | |
| GTE CORPORATION, |) | |
| |) | |
| Transferor, |) | |
| |) | |
| and |) | CC Docket No. 98-184 |
| |) | |
| BELL ATLANTIC CORPORATION, |) | |
| |) | |
| Transferee, |) | |
| |) | |
| For Consent to Transfer of Control |) | |

**SUPPLEMENTAL DECLARATION OF
PROFESSOR JOHN C. COFFEE**

1. I make this declaration to supplement my earlier declaration, dated March 10, 2000, in which I argued that (i) Bell Atlantic Corporation ("Bell Atlantic") and GTE Corporation ("GTE"; collectively "BA-GTE") had misunderstood and misapplied the securities law principles and concepts that they had themselves cited in their initial submission to this Commission, and (ii) the possession of a convertible security that entitled one to acquire 80% of the equity interest in a company without making any additional investment would certainly be treated as conferring "control" and would be viewed as giving the "equivalent" of an interest of greater than 10% (particularly when it was conceded that the remaining equity interest would only trade in the market at approximately 20% of this company's going concern value). BA-GTE has now

responded in its March 14, 2000 filing by saying that the federal securities laws “are irrelevant to the issue of equity ownership and control under sections 3(1) and 271...” Of course, this is a remarkable piece of broken-field running, as BA-GTE have essentially reversed their initial position by 180 degrees; more important, however, is their justification for now arguing that concepts they originally saw as highly relevant have on reconsideration no relevance. As they now view the federal securities laws, they “are intended to stem irregularities in the trading of any valuable financial instrument -- ‘prohibiting insider trading, assuring disclosure, and preventing fraud.’ ” (Reply of Bell Atlantic and GTE to AT&T’s March 10 Ex Parte at p. 1). Although the federal securities laws do all these things, this is a woefully inaccurate characterization of the SEC’s overall jurisdiction or, most importantly, of the specific purposes for which the SEC’s definition of “control” was developed. A little knowledge of the federal securities laws can prove to be a dangerous thing.

2. In this Supplemental Declaration, I will suggest that there is a common purpose that runs through most statutes (including all the federal securities laws and, I believe, the Communications Act of 1934) that have utilized the concept of “control”: namely, to prevent circumvention of the statute’s purposes by artful maneuvers. Further, I will suggest that BA-GTE have adopted the paradigm of such a technique in their use here of a convertible security.

3. Initially, if one examines the purposes for when the SEC developed its definition of control (which BA-GTE now concede would treat convertible securities as if they represented shares of the underlying stock), one finds that the SEC was facing problems that are functionally very similar to those now faced by FCC under Section 271. As Professors Loss and Seligman write in their treatise:

“Most of the early SEC control cases arose under the Holding Company Act.” See L. Loss and J. Seligman, *Securities Regulation* (3rd ed. 1990) at p. 1711.

The “Holding Company Act” to which they refer is the Public Utility Holding Company Act of 1935. As Professors Loss and Seligman further note in their treatise:

“The provisions of the Holding Company Act with respect to the issuance of securities are not aimed at disclosure. They have the quite different purpose of giving the Commission ‘continuous supervision over the revamping of holding-company systems to meet the requirements of [the Act] looking toward the establishment of financially sound and economically integrated units and the avoidance of injury to investors and consumers.’” L. Loss and J. Seligman, *supra*, at 806-07 (quoting S. Rep. No. 621, 74th Cong., 1st Sess. 28 (1935)).

4. In effect, Congress gave the SEC substantive power to regulate public utility holding companies, and the SEC initially developed its definition of “control” in this context to determine which companies were subject to this regulation. Congress’s goal was to reduce the excessively leveraged character of public utility holding companies (which made them prone to bankruptcy), and it therefore gave the SEC power to regulate the capital structure of holding companies. This purpose in turn gave rise to inevitable definitional issues as to when the relationship between the two companies made the shareholder company a statutory “holding company.” Under Section 2(a)(7) of the Public Utility Holding Company Act, if a corporation owning shares in a public utility company also possessed “control” or a “controlling influence,” it thereby became a holding company (absent some special exemptions), and its capital structure would then become subject to the substantive regulation of the SEC (which was instructed to pursue a more balanced capital structure by restricting the issuance of debt and debt securities).

5. Against this backdrop, it is now useful to turn to Professor Gilson’s explanation for

why the meaning of “control” under the federal securities laws is irrelevant to the FCC’s concerns. He argues that because the purposes of the federal securities laws are “prohibiting insider trading, assuring disclosure, and preventing fraud,” these purposes “dictate[...] an encompassing definition of the jurisdictional trigger.” (Gilson’s Supplemental Declaration at Par. 4). In contrast, he argues that “[t]he ends sought to be achieved by Sections 271 and 3(1) of the Communications Act...are entirely different: to avoid circumvention of Section 271(a)’s requirement of FCC’s approval...” (Gilson’s Declaration at Para. 5). Although this might be a plausible argument in the abstract, it is historically precisely backwards. The definition of “control” under the federal securities laws developed in a context where the SEC was not seeking to prevent fraud or assure disclosure, but rather to prevent “circumvention” (in Professor Gilson’s phrase) of the SEC’s substantive authority to regulate the capital structure of public utility holding companies.

6. To illustrate, the SEC’s concern was that a company might outflank the Public Utility Holding Company Act’s coverage by, for example, owning only 10% of the operating utility company’s stock plus an option to convert convertibles securities into 80% of its common stock. If this worked, then the SEC would lose its jurisdiction to regulate the capital structure of that parent company (and its ability to reduce such holding company’s level of leverage). Accordingly, the SEC formulated a test for the determination of control that relied in part on the Supreme Court’s definition of “control” in the Rochester Telephone case, which was decided under the Communications Act of 1934.¹ Applying this test, the D.C. Circuit has held that, under the Public Utility Holding Company Act, “latent power” is sufficient to constitute a “controlling

¹ See Rochester Tel. Corp. v. United States, 307 U.S. 125, 145-46 (1939)

influence.”² See Koppers United Co. v. SEC, 138 F.2d 577, 580-81 (D.C. Cir. 1963). Earlier, in sustaining the constitutionality of the Public Utility Holding Company Act, the Supreme Court wrote even more broadly:

“Historical ties and associations, combined with strategic holdings of stock, can on occasion serve as a potent substitute for the more obvious forms of control.... Domination may spring as readily from subtle or unexercised power as from arbitrary imposition of command.” North Am. Co. v. SEC, 327 U.S. 686, 693 (1946).

Under Professor’s Gilson’s proposed analysis, however, the Supreme Court has apparently got it wrong.

7. The Public Utility Holding Company Act is not the only statutory context in which the SEC has interpreted the term “control” in order to protect its right to exercise substantive regulatory power over a special class of businesses that Congress deliberately subjected to its control. Another example is the Investment Company Act of 1940, pursuant to which Congress gave the SEC broad regulatory authority over mutual funds and their investment advisers. Although Congress here chose the threshold of 25% for its automatic presumption of control (rather than the 10% level that it used in both the Communications Act of 1934 and the Public Utility Holding Company Act of 1935), Congress also provided that any person (regardless of stock ownership) who held “the power to exercise a controlling influence over the management or

² As with the Communications Act of 1934, the Public Utility Holding Company Act does not define the term “control” (but does define the term “affiliate” in a manner that closely parallels the Communications Act); in addition, the Public Utility Holding Company Act provides that any “company which directly or indirectly owns, controls, or holds with power to vote” 10% of the outstanding voting securities of a public utility company is itself a holding company, unless it can demonstrate that it is exempt because, *inter alia*, it does not possess a “controlling influence.” See Sections 2(1)(7), 2(a)(8) and 2(a) (11) of the Public Utility Holding Company Act of 1935.

policies of a company” was to be deemed in “control” (See Section 2(a)(9) of the Investment Company Act of 1940). As under the Holding Company Act, the SEC has read this power broadly using the same pragmatic test for “control.” Still another example of this same approach is supplied by the Trust Indenture Act of 1939, which is also a substantive, regulatory statute, rather than simply a disclosure statute. Again, the SEC has used essentially the same definition of “control.” See J.P. Morgan & Co., 10 SEC 119 (1941).

8. More importantly, across all these contexts (investment companies, public utilities, trust indenture regulation) and later across the rest of the federal securities laws generally, the SEC adopted, and the courts have upheld, the same practical methodology for determining “control.” See Chicago Corporation, 28 SEC 463 (1948). This test has consistently looked to who has the beneficial enjoyment and control over the securities, not who the legal owner is (See Ronson Corp. v. Liquifin AG, 370 F. Supp. 597, 604-05 (D. N.J. 1974), aff’d per curiam, 797 F.2d 397 (3rd. Cir. 1974)), has refused to defer to insulating devices, such as a voting trust (See H.M. Byllesby & Co., 6, SEC 639, 657 (1970)), and has considered the actual influence held over corporate officers (See Resources Corp. Int’l, 7 SEC 689, 716-718 (1940)). Using this test, the SEC found early in its history that options and convertible securities can convey control. See Walston & Co., 7 SEC 937, 947-51 (1940) (creditor who also held options to acquire equity found to be in control of a broker-dealer).

9. Professor Gilson now concedes that convertible securities are deemed to be equity securities for purposes of Section 16(b) of the Securities Exchange Act of 1934, but dismisses this point as irrelevant because the purpose (as he sees it) of Section 16(b) is to restrict “insider trading.” In fact, the real issue that the SEC faced under Section 16(b) was determining when a

person or entity should be deemed to possess control. Congress provided in Section 16(b) that its restrictions on “short-swing profits” applied to 10% shareholders because Congress assumed that 10% shareholders would have sufficient power and influence to give them access to inside information. But Congress did not define how to measure the ownership of 10%. Instead, by rule (Rule 16a-4), the SEC found that a shareholder who owned less than 10%, but who also owned an option or other derivative security to purchase additional shares, would be deemed to be such a covered 10% or greater shareholder if the option on its conversion would give such shareholder more than 10%. In truth, this was a finding about the meaning of “control,” not the need for full disclosure. In effect, the SEC has found that an option or conversion right is the “equivalent” of stock when the option (on conversion) plus the underlying stock ownership together would exceed 10% of the underlying class.

10. Correspondingly, the SEC would in my judgment follow this same approach under its other statutes. Although the Public Utility Holding Company Act has now been largely dismantled, I am confident that in the past the SEC would have found that a holding company that had reduced its ownership of a public utility company below 10%, but had received in return a convertible security that it could convert into majority ownership, remained in “control” of the public utility company and was therefore still a regulated “holding company” under the Public Utility Holding Company Act.

11. Professor Gilson is thus in error when he seeks to argue that a stock option “is an equity security for purposes of the application of securities law insider trading, disclosure and anti-fraud rules,” but not for other purposes (Gilson Declaration at Para. 6). The truth is that the SEC developed its definition of “control” in the context of statutes unrelated to disclosure, insider

trading, or anti-fraud concerns in order to prevent circumvention of statutory policies that required the SEC to make affirmative findings about whether the controlling company should be permitted to operate the controlled company in the public interest.

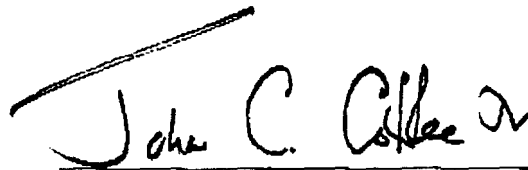
12. My point is not just that an ounce of history is often worth more than a pound of formal logic, but that the formal logic of BA-GTE's position is also wrong. The SEC's approach to the issue of control determination has been based on long practical experience in this field. It has found that "control" is a practical question, which should be evaluated by looking to how power can be exercised, not by limiting one's focus to the formal "corporate participation rights" that the party designing the transaction has elected to give itself. Justice Holmes said it best: "The life of the law has not been logic; it has been experience."

13. To this point, my focus has been restricted to the field of securities law (and I do not claim expertise in the field of federal communications law). I do believe, however, that the SEC's experience has broad relevance to other federal agencies. Based on similar statutory language that appears in the Securities Act of 1933, the Communications Act of 1934, and the Public Utility Holding Company Act of 1935, the SEC developed its definition based on its experience with the various tactics that can be used to insulate or hide control and thereby avoid its regulatory oversight. If the Federal Communications Commission were to adopt a narrow, formalistic test under which an 80% option did not confer "control," this form of loophole could quickly become a triumphal arch through which talented lawyers could march a broad variety of transactions so as to avoid FCC scrutiny.

14. For example, a parent corporation could place acquired assets, which it otherwise could not control, in a shell corporation that would be financed 90% or more with debt advanced

by the parent (with such debt instrument containing negative covenants that permitted the parent to veto and thus effectively manage many day-to-day affairs of this de facto subsidiary); further, the debt instrument could contain a conversion right that entitled the parent to convert some or all of its debt into 95% or more of the subsidiary's equity over a twenty year period. This structure is in fact only a marginal extension over what BA-GTE have here proposed. Such a parent would clearly hold control because any other equity participants (or the subsidiary's outside directors) would understand that their small ownership stake was at the sufferance of the true parent. In effect, once the loophole proposed by BA-GTE is accepted, complete circumvention becomes possible. There is no logical stopping point on the slippery slope that begins with finding options and convertible securities to be exempt from the FCC's jurisdiction over "control" transactions. Indeed, the predictable next step in my judgment would be to dispense with public shareholders and instead "park" the Class A stock with a cooperative investment banking firm or other financial institution that would be only too happy to serve as the token equity shareholder for a fee. The simplest way to preclude such exotic transactions is to recognize (as the SEC long has) that options can confer control.

I declare under the penalties of perjury that the foregoing is true and correct to the best of my knowledge and belief.

A handwritten signature in black ink, reading "John C. Coffee Jr." with a stylized flourish at the end. The signature is written over a horizontal line.

John C. Coffee, Jr.

March 21, 2000
New York, New York